UK economy returns to growth after volatile fourth quarter

A rebound in retail activity helped the UK economy bounce back in January, and the combination of falling gas prices and the anticipation of rate cuts suggests we should see an improvement in growth through 2024

We think we should see a return towards quarterly growth prints in the 0.3% area later this year.

The UK economy bounced back in January following a volatile but overall weak fourth quarter. Monthly GDP increased by 0.2%, some of which is thanks to a strong rebound in retail activity after an unexpectedly weak Christmas trading period.

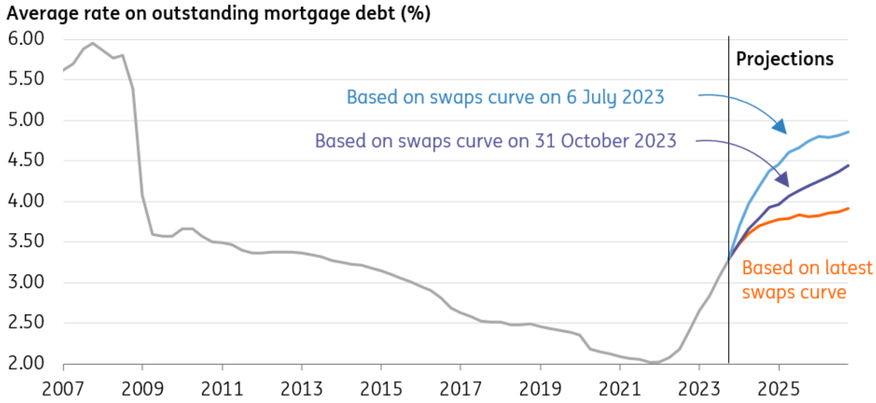
It's worth emphasising that these GDP figures have been all over the place over the past few months, not least in manufacturing where a large drop in October's production numbers gave way to a swift recovery in November and December. Manufacturing was flat in the first month of this year.

We therefore shouldn't overstate one month's worth of GDP figures, but we think it is consistent with the gradual recovery in activity that we expect over the coming months. We think the decline in overall fourth quarter GDP, which marked the second consecutive quarter of negative growth and therefore a technical recession, is unlikely to be repeated in the first quarter of 2024.

There are green shoots in some of the major business surveys, including the services PMI, which at 53.8, is not only in expansionary territory but also sits some way above the equivalent eurozone series. We also expect a better year for the UK consumer with rate cuts on the horizon and given the recent fall in wholesale gas prices.

On the former, we estimate that two-thirds of the passthrough from rate hikes to homeowners via mortgage refinancings has already happened, and this will rise to around 80% by the summer. The average rate being paid on outstanding mortgages (not the rate on new lending) has risen from 2% to 3.3% as of the fourth quarter. Based on the latest market pricing for the Bank of England, we think that will rise to 3.7% by year-end.

Most of the passthrough from rate hikes to mortgage-holders has already happened



Source: Macrobond, ING calculations

Projections are based on the split of mortgage lending by initial fixation period, and assume an even proportion of borrowers refinance each quarter (for example, one eighth of those with two-years fixes). We have also assumed that a recent bias towards shorter fixation periods for those refinancing persists such that the share of those with two-year fixes gradually climbs.

The fall in gas prices is set to usher in a 12% fall in household energy bills at the start of April and potentially another sizable fall at the start of July. That will drag headline inflation below 2% by May at the latest, where it's likely to stay for much of this year. With wage growth still at 6% and set to fall only gradually into the summer, real wage growth should be decent and will help support spending later this year. At the margin, recent tax cuts will also add to this story.

We shouldn't get ahead of ourselves, but we think we should see a return towards quarterly growth prints in the 0.3% area later this year.

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